The Chapman University Economic Forecast
For the U.S., California and Orange County

Orange, CA – The A. Gary Anderson Center for Economic Research at Chapman University released today the results of its 29th annual economic forecast for the U.S., California and Orange County. The forecast was presented to more than 1,000 Orange County business leaders at a conference held at the Hyatt Regency, Irvine. Following are highlights of the forecasts.

2007 U.S. Forecast:

- Chapman’s real GDP forecast calls for quarterly growth within a narrow range of 1.5 to 3.0 percent through 2007. On an annual basis, real GDP growth will decline from 3.3 percent currently estimated for 2006 to 2.1 percent in 2007.

- This forecast for a continuation of the current economic expansion is buttressed by two highly reliable recessionary indicators: the difference between long- and short-term interest rates and the real (inflation-adjusted) federal funds rate. While both indicators have been moving in a direction that suggests a slowdown in economic growth, neither has yet moved far enough to be a clear recessionary signal.
While the residential construction sector appears to be in freefall, those spending losses have been offset by strong growth on the nonresidential side. Overall, total construction spending is virtually unchanged on a year-to-year basis.

There is still a danger that declining housing prices could put a wrench in consumer spending – not unlike the negative wealth effect caused by the bursting of the dot-com bubble that led to the stock market crash and subsequent drop in consumer spending in 2001.

To assess that danger, the Anderson Center developed a new model to forecast housing appreciation at the national level. The model points to housing prices dropping 2.2 percent, on average, in 2007. Such a moderate decline would not be expected to lead to a negative wealth effect, especially given the sharp run-up in average housing prices since the late 90s. For example, the median resale price of a home increased from $137,000 in 2000 to almost $225,000 by 2006.

Lower gas prices are expected to bring the all-items CPI down from a high of almost 5 percent quarter-to-quarter growth reached in the second quarter of 2006 to 2.6 percent by the second quarter of 2007. The Fed’s preferred price gauge, however, is the personal consumption expenditures price index: less food and energy, which recently hit 2.5 percent – well above the Fed’s target range of 1 to 2 percent. Our forecast points to core inflation moderating in 2007 to the top end of this range.

Since lowering the fed funds rate will set off an inflationary alarm and raising it may be more than a weakening economy can take, we believe the Fed will hold this key interest rate constant at 5.25 percent in 2007. Other short-and long-term interest rates will follow suit and remain fairly stable through the end of next year.

2007 California Forecast:

After four consecutive years of robust demand for housing and double-digit home price appreciation, the housing market is showing a sharp decline in sales activity and price appreciation.

Looking forward, the pace of job growth is slowing, the inventory of resale housing units is high, housing affordability is low, mortgage rates, particularly popular...
adjustable rate mortgages, have increased, and regulators are warning lenders to curtail easy lending practices. More importantly, expectations about future home price increases have turned negative. All of the above suggest that the housing market's adjustment process is gathering steam. Our model points to a decline of 6.7 percent in the median resale single-family detached home prices.

- The building industry is responding to the new market paradigm by drawing fewer permits. We are forecasting a decrease of 12.4 percent in total number of residential permits in 2007. This will mark three consecutive years of decline in the total number of permits issued since the peak of 213,000 units in 2004. In spite of relatively strong nonresidential construction activity, weakness in the residential sector will lead to 13,500 job losses in the construction sector in 2007.

- Overall, our forecast calls for net job creation of 139,000 in 2007 — a rate of increase of only 0.9 percent. Most of the net new jobs will be in the services sector. The most rapid growth is forecasted to take place in the professional & business sector increasing 2.1 percent, followed by growth of 1.8 percent in both leisure & hospitality and education & health services sectors.

- The slowdown in California job growth in 2007 will be the major factor leading to a slowing in personal income growth from an estimated 6.4 percent in 2006 to 5.5 percent in 2007. Weak real income growth, a sharp reduction in cash-out refinancing activity and weakening of home price appreciation will negatively affect taxable sales activities. Our forecast calls for total taxable sales to increase by 4.7 percent in 2007, compared to an estimated growth rate of 6.6 percent in 2006. Spending growth on furniture and appliances, building materials and service stations are forecasted below the average growth rate of 4.7 percent.
2007 Orange County Forecast:

- While the maturing of Orange County has resulted in lower and lower expansionary peaks, the county’s job growth has continued to outpace the nation in every major category. Most of the growth differential has been in the construction and construction-related financial activities sectors.

But now, largely as a result of the county’s weakening construction sector, the U.S. has caught up with Orange County with both showing job growth of around 1.3 percent in the most recent quarterly reports. This points to the fact that the disproportionately high level of construction activity in Orange County means that a downturn in construction will have a relatively greater negative impact in the county.

- We expect job growth to continue the downward trend that began this year. The one percent job growth we are forecasting for 2007 translates to the addition of 15,000 new jobs as compared to estimated growth of 1.4 percent or 21,000 jobs in 2006.

Together, the construction and financial activities sectors are forecasted to lose about 2,000 jobs next year.

- The weakening construction sector is also negatively affecting taxable sales with lower growth in two construction-relates sectors: “Furniture & Appliances” and “Building Materials.” Total taxable sales activity is forecasted to drop from 6.8 percent growth in ’06 to 5.0 percent in ’07.

- Similar to the national trend, nonresidential construction spending in the county is helping to offset a decline in residential construction. Although residential permit valuation is forecasted to drop from $2.3 billion in ’06 to $2.1 billion in ’07, nonresidential permit valuation is forecasted to increase from $2.3 to $2.4 billion. Total building permit valuation is forecasted to decline from $4.6 billion in ’06 to $4.5 billion in ’07 – still quite strong when compared to earlier years.

- The county’s housing affordability problem is much greater than that in the nation. The percent of median family income needed for a mortgage payment on a median-priced home is currently 55 percent in Orange County as compared to 24 percent in the U.S.
• Between 2002 and 2005, Orange County’s housing appreciation rate far outpaced the national average. Now that the price trend has turned down, it’s likely that Orange County will experience even greater depreciation than the projected national average of 2.2 percent reported above. We are forecasting resale single-family housing price depreciation of 6.4 percent in 2007.
ABOUT THE ANDERSON CENTER FOR ECONOMIC RESEARCH:

The A. Gary Anderson Center for Economic Research (ACER) was established in 1979 to provide data, facilities and support in order to encourage the faculty and students at Chapman University to engage in economic and business research of high quality, and to disseminate the results of this research to the community.

ANNUAL SCHEDULE OF CONFERENCES AND PRESS RELEASES:

JANUARY  ‣ Economic Forecast Conferences for Los Angeles County and the Inland Empire
       ‣ California Purchasing Managers Survey

FEBRUARY  ‣ California Leading Indicator

MARCH  ‣ California Consumer Sentiment Survey

APRIL  ‣ California Purchasing Managers Survey

MAY  ‣ California Leading Indicator

JUNE  ‣ Economic Forecast Update Conference for the U.S., California, Orange and Los Angeles counties, and the Inland Empire
       ‣ California Consumer Sentiment Survey

JULY  ‣ California Purchasing Managers Survey

AUGUST  ‣ California Leading Indicator

SEPTEMBER  ‣ California Consumer Sentiment Survey

OCTOBER  ‣ California Purchasing Managers Survey

NOVEMBER  ‣ California Leading Indicator

DECEMBER  ‣ Economic forecast conference for the U.S., California and Orange County
       ‣ California Consumer Sentiment Survey